Report

of the

Examination of

MSI Preferred Insurance Company

West Allis, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

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July 9, 2004

Honorable Kevin McCarty
Chairman, Financial Condition (E)
Committee, NAIC
Director, Office of Insurance Regulation
State of Florida
200 East Gaines Street
Tallahassee, Florida 32399-0327

Honorable Jorge Gomez
Secretary, Midwestern Zone, NAIC
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioners:

In accordance with the instructions of the Wisconsin Commissioner of Insurance, a compliance examination has been made of the affairs and financial condition of:

MSI PREFERRED INSURANCE COMPANY
West Allis, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of MSI Preferred Insurance Company (the company) was conducted in 2000 as of December 31, 1999. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

The examination was conducted in cooperation with the Illinois Insurance Department. Work performed by the Illinois Insurance Department was utilized to the extent deemed appropriate.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1984 as MSI Insurance Company (MSI). On November 30, 1999, Mutual Service Casualty companies, including MSI Insurance Company, and the Country Mutual companies entered into an Alliance Agreement. The overall intent of the alliance was to operate the current personal and small business property/casualty business of the Mutual Service Casualty companies on a 60%/40% ownership basis. On June 27, 2000, Mutual Service Casualty Insurance Company sold 60% of MSI to Country Mutual Insurance Company. In addition, the corporate name of MSI Insurance Company was changed to MSI Preferred Insurance Company. The commissioner approved the change of control request on April 5, 2000.

The company writes direct premium in the following states:

Wisconsin	$24,883,318	95.2%
Minnesota	1,245,318	4.8
North Dakota	6,892	0.0
Total	$26,135,528	100.0%

The major products marketed by the company include auto and homeowners' coverages. The business is 100% ceded under a quota share agreement to Country Mutual Insurance Company, the company's parent. The major products are marketed through 220 captive agents.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Homeowners multiple peril	$ 5,449,662	$0	$ 5,449,662	$0
Inland marine	166,684	0	166,684	0
Earthquake	961	0	961	0
Private passenger auto liability	11,679,466	0	11,679,466	0
Auto physical damage	8,838,756	0	8,838,756	0
Total All Lines	$26,135,529	$0	$26,135,529	$0

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members. All directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. Outside directors currently receive an annual retainer of $5,000 and a per diem of $300 for serving on the board. In addition, all board members receive reimbursement of expenses according to the company's directors' compensation policy.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Barbara A. Baurer El Paso, Illinois	President, MSI Preferred Ins Co	2004
John D. Blackburn Lincoln, Illinois	Chairman of the Board, MSI Preferred Ins Co	2004
Paul M. Harmon Normal, Illinois	Executive VP, General Counsel and Secretary, MSI Preferred Ins Co	2004
David A. Magers Bloomington, Illinois	Executive VP and Vice Chairman, MSI Preferred Ins Co	2004
Terrence J. Bohman Bloomington, Minnesota	President and Chief Executive Officer, Universal Cooperatives, Inc.	2004
Gasper Kovach, Jr. Lakeland, Florida	Chief Executive Officer, HESCO	2004
John B. Shaffer Pipestone, Minnesota	President and Owner, Shaffer Farms Inc.	2004

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation*
John D. Blackburn	Chairman of the Board	$508,327
David A. Magers	Executive Vice President and Vice Chairman	189,970
Barbara A. Baurer	President	359,723
Deanna L. Frautschi	Executive Vice President	200,667
Paul M. Harmon	Executive Vice President, General Counsel and Secretary	229,836
Robert W. Rush, Jr.	Executive Vice President	267,919
Doyle J. Williams	Executive Vice President	196,638
Richard A. Bill	Vice President and Chief Actuary	213,199
Joseph E. Painter	Vice President, Customer Service Operations	209,140
Shelly S. Prehoda	Vice President, Information Technology	153,715
Robert L. Gaecke	Vice President and General Manager, MSI Property/Casualty Operations	248,377
Joseph J. Pingatore	Vice President, Senior Counsel and Assistant Secretary	180,176
Alan T. Reiss	Vice President, Information Systems	215,642
Stephen R. Ricklefs	Vice President, Agency – MSI	293,281
Stephen L. Rohde	Vice President, Chief Financial Officer and Treasurer	284,559
Gilbert F. Wenzel	Vice President, Human Resources	181,493

* Compensation reported is total compensation paid by all companies. Officers are employees of either CC Services or MSI Preferred Services.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
John D. Blackburn, Chair
David A. Magers
Barbara A. Baurer
Paul H. Harmon
Terrence J. Bohman
Gasper Kovach, Jr.
John B. Shaffer

Audit Committee
Terrence J. Bohman, Chair
Gasper Kovach, Jr.
John B. Shaffer

Investment Committee
John D. Blackburn, Chair
David A. Magers
Bruce D. Finks

IV. AFFILIATED COMPANIES

MSI Preferred Insurance Company is a member of a holding company system. Its ultimate parent is Illinois Agricultural Association. Control of MSI Preferred was acquired in 2000 by Country Mutual Insurance Company (CMIC) with the purchase of 60% of the company's voting stock from Mutual Service Casualty Insurance Company (MSC).

The company has no employees of its own, but is a party to agreements with and among the companies in the holding company group, predominantly with the affiliated companies discussed below. These agreements are deliberately structured to effect an orderly transition of administrative services from MSI Preferred Services to CC Services, Inc. Affiliated companies provide services including but not limited to administrative, actuarial, claims, information technology, investment advisory, and underwriting. Expenses are allocated among the affiliated companies based on the allocation methods appropriate for the nature of the expenses.

The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the ultimate parent and significant affiliates with which the company has agreements follows the organizational chart.

Organizational Chart
As of December 31, 2002

Illinois Agricultural Association

- Country Mutual Insurance Company[1]
  - Country Casualty Insurance Company
  - Country Preferred Insurance Company
  - Modern Service Insurance Company
  - Mid-America Brokerage, Inc
  - Middlesex Mutual Assurance Company
  - Holyoke Mutual Insurance Company
  - CC Services, Inc.
  - MSI Preferred Insurance Company
  - MSI Preferred Services, Inc.
  - Mutual Service Casualty Insurance Company[2]
    - MSI Preferred Insurance Company
    - MSI Preferred Services, Inc.
- Illinois Agricultural Holding Company
  - Country Life Insurance Company
    - Country Investors Life Assurance Company
    - Country Capital Management Company
    - Country Medical Plans
    - CC Services, Inc.
    - Country Trust Bank
    - Mutual Service Life Insurance Company
- CC Services, Inc.

[1] Policyholders are members of the corporation and are entitled to one or more votes based on insurance in force, number of policies held, or the amount of premium paid as may be provided in the Bylaws. Such members may vote in person or by proxy, and may appoint the Board of Directors of the Illinois Agricultural Association as their lawful attorney in their name to vote for them at any meeting of the members of CMIC. A majority of policyholders have chosen to make such a proxy appointment to the Board of

Directors of the Illinois Agricultural Association. This proxy is to remain in force until expressly revoked.

[2] Control is maintained by CMIC through control of the Board of Directors and management of MSC. Certain officers of CMIC constitute a majority of the Board of Directors and in addition certain officers also maintain senior officer positions in MSC.

Illinois Agricultural Association (IAA)

IAA is an Illinois not-for-profit agricultural organization organized to promote agriculture and instituted for the mutual help of its members. IAA owns 98.3% of the voting securities of Illinois Agricultural Holding Company, 71.4% of the voting securities of CC Services Inc, and controls CMIC as detailed above.

As of August 31, 2002, the company's audited financial statement reported assets of $34,770,362, liabilities of $4,810,838, and net assets of $29,959,524. Operations for 2002 produced revenues in excess of expenses of $244,051.

Country Mutual Insurance Company.

CMIC, a property and casualty insurance company, was the result of the 1957 merger of Country Mutual Fire Company and Country Mutual Casualty Company. Country Mutual Fire Company was incorporated under the laws of Illinois in 1925 under the name of Farmers Mutual Reinsurance Company, while Country Mutual Casualty was incorporated under the laws of Illinois as Illinois Agricultural Mutual Insurance Company in 1926. Both names were changed in 1946 to those in use at the time of the merger. Major products marketed include automobile and homeowners' coverages.

As of December 31, 2002, the company's audited financial statements reported assets of $2,229,023,622, liabilities of $1,275,835,073, and policyholders' surplus of $953,188,549. Operations for 2002 produced net income of $4,868,115.

Mutual Service Casualty Insurance Company

MSC, a property and casualty insurance company, was incorporated under the laws of Minnesota in 1919 as American Farmers Mutual Automobile Insurance Company. The name was changed to the one presently used in 1949. Its principal lines of business include automobile and homeowners' coverages.

Prior to the change in control of the Mutual Service Companies in 1999, MSC owned 100% of MSI Preferred and assumed 100% of its business. Any obligations of MSC remaining under the reinsurance agreement, which terminated December 31, 1999, were commuted as of January 1, 2003.

As of December 31, 2002, MSC’s audited financial statement reported assets of $157,930,638, liabilities of $119,103,774, and policyholders’ surplus of $38,826,863. Operations for 2002 produced net income of $5,087,922.

MSI Preferred Services (MSIPS)

MSIPS, an Illinois corporation which is 60% owned by CMIC and 40% owned by MSC, was established in October 1999, initially to hold agents licenses. MSIPS acts as the fiscal agent for members of the former Mutual Service group, a function performed by Mutual Service Cooperative (Cooperative) prior to the change in control. In September 2002, the assets and liabilities of the Cooperative were transferred to MSIPS through an assignment and assumption agreement and bill of sale, and the employees of the Cooperative became employees of MSIPS. MSIPS also incurs expenses on behalf of, and receives reimbursements from CC Services, Inc. and Country Life Insurance Company. It is not operated to make a profit in its role as fiscal agent.

As of December 31, 2002, the company's audited financial statement reported assets of $15,276,533, liabilities of $15,180,075, and shareholders equity of $96,458. Operations for 2002 produced a net loss of $1,942.

CC Services, Inc.

CC Services was incorporated under the laws of Illinois in 1976. In addition to the 71.4% of voting securities owned by IAA, 17.1% of voting securities are owned by CMIC, and 11.4% of voting securities are owned by Country Life Insurance Company. CC Services originally provided employees and acted as the fiscal agent for members of the Country group. Currently, the services now provided by MSIPS are being transitioned to CC Services. It is expected that all employees of MSIPS will be transferred to CC Services by January 2005.

As of December 31, 2002, the company's audited financial statement reported assets of $155,143,000, liabilities of $137,249,000, and stockholders equity of $17,894,000. Operations for 2002 produced net income of $824,000.

Country Trust Bank

Country Trust Bank is a federally chartered saving bank providing trust services to its customers. It is owned and controlled by IAA through a subsidiary of IAA, the Illinois Agricultural Holding Company, and 100% of voting securities are owned by Country Life Insurance Company.

Country Trust Bank provides investment advisory services for the affiliates of the group in return for a fee based upon the member’s investment holdings.

As of December 31, 2002, the company's audited financial statement reported assets of $30,409,670, liabilities of $3,661,383, and stockholders’ equity of $26,748,287. Operations for 2002 produced net income of $2,305,404.

V. REINSURANCE

The company's reinsurance program consists of a quota share reinsurance agreement with CMIC whereby the company cedes, and CMIC assumes, 100% of net premiums written, net losses and LAE paid, and net loss and LAE reserves. The company is also included with the following members of the Country Mutual Insurance Group in reinsurance agreements which consist of CMIC ceding excess layers to American Agricultural Insurance Company (AAIC). The cession of the excess layers limits the exposure to CMIC's reinsurance pool.

Country Mutual Insurance Company
Country Preferred Insurance Company
Country Casualty Insurance Company
Middlesex Mutual Assurance Company
Holyoke Mutual Insurance Company
Mutual Service Casualty Insurance Company
MSI Preferred Insurance Company
Modern Service Insurance Company

CMIC is authorized as attorney in fact to act in its own name for all the reinsureds listed in the agreements. There is limited participation by the company under these excess reinsurance agreements, since the company does not insure all types of risks covered by the reinsurance and policy limits frequently do not reach retention levels.

The following is a summary of the agreement with CMIC. The remaining cessions by CMIC to AAIC are not included due to the limited participation by MSI Preferred. The contracts were reviewed, and all contained proper insolvency provisions.

Further discussion regarding the settlement of reinsurance balances can be found at the section titled "Summary of Current Examination Results."

Affiliated Ceding Contracts

1.	Type:	Quota Share
	Reinsurer:	Country Mutual Insurance Company
	Scope:	All business written by the company
	Retention:	None
	Coverage:	100%

Premium:	100% of net premium written
Commissions:	Based on a commission ratio defined in the contact. The ratio is the company's underwriting expenses divided by net premiums written.
Effective date:	November 15, 2001
Termination:	The agreement is indefinite in term, but certain termination provisions apply at the option of the reinsurer. The agreement shall be terminated if the Alliance Agreement is terminated.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2002, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

MSI Preferred Insurance Company
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$11,907,469	$ 0	$11,907,469
Cash	19,712	0	19,712
Short-term investments	1,423,170	0	1,423,170
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	587,931	29,818	558,113
Premiums, agents' balances, and installments booked but deferred and not yet due	569,819	0	569,819
Bills receivable, taken for premiums	2,655,681	0	2,655,681
Reinsurance recoverable on loss and loss adjustment expense payments	1,402,236	0	1,402,236
Federal and foreign income tax recoverable and interest theron	300,716	80,693	220,023
Interest, dividends, and real estate income due and accrued	168,579	0	168,579
Receivable from parent, subsidiaries, and affiliates	757,899	0	757,899
Write-ins for other than invested assets:			
Other Assets	249,348	249,348	0
Total Assets	$20,042,560	$359,859	$19,682,701

MSI Preferred Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Commissions payable, contingent commissions, and other similar charges		$ 100,090
Other expenses (excluding taxes, licenses, and fees)		100,158
Taxes, licenses, and fees (excluding federal and foreign income taxes)		28,810
Advance premium		1,485,779
Ceded reinsurance premiums payable (net of ceding commissions)		5,970,591
Drafts outstanding		1,208,251
Payable to parent, subsidiaries, and affiliates		241,827
Total Liabilities		9,135,506
Common capital stock	$2,500,000	
Gross paid in and contributed surplus	7,387,434	
Unassigned funds (surplus)	659,762	
Surplus as Regards Policyholders		10,547,196
Total Liabilities and Surplus		$19,682,702

MSI Preferred Insurance Company
Summary of Operations
For the Year 2002

Underwriting Income		
Premiums earned		$ 0
Deductions:		
Other underwriting expenses incurred	$ 99,272	
Total underwriting deductions		99,272
Net underwriting gain or (loss)		(99,272)
Investment Income		
Net investment income earned	492,512	
Net investment gain or (loss)		492,512
Other Income		
Net gain or (loss) from agents' or premium balances charged off	(48,923)	
Write-ins for miscellaneous income:		
Miscellaneous Income	6,553	
Total other income		(42,370)
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		350,870
Dividends to policyholders		0
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		350,870
Federal and foreign income taxes incurred		127,846
Net Income		$223,024

MSI Preferred Insurance Company
Cash Flow
For the Year 2002

Premiums collected net of reinsurance			$4,493,591
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)			60,736
Underwriting expenses paid			940
Cash from underwriting			4,431,914
Net investment income			480,366
Other income (expenses):			
Agents' balances charged off		$ (48,923)	
Write-ins for miscellaneous items:			
Miscellaneous Income		6,553	
Total other income			(42,370)
Deduct:			
Federal income taxes paid (recovered)			303,544
Net cash from operations			4,566,366
Proceeds from investments sold, matured, or repaid:			
Bonds		312,392	
Cost of investments acquired (long-term only):			
Bonds		4,156,004	
Net cash from investments			(3,843,612)
Cash provided from financing and miscellaneous sources:			
Other cash provided		368,250	
Cash applied for financing and miscellaneous uses:			
Net transfers to affiliates	$302,392		
Other applications	200,905		
Total		503,297	
Net cash from financing and miscellaneous sources			(135,047)
Reconciliation			
Net change in cash and short-term investments			587,707
Cash and short-term investments, December 31, 2001			885,174
Cash and short-term investments, December 31, 2002			$ 1,442,881

MSI Preferred Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2002

Assets		$19,682,701
Less security surplus of insurance subsidiaries		
Less liabilities		9,135,506
Adjusted surplus		10,547,195
Annual premium:		
Lines other than accident and health	$26,135,529	
Factor*	10%	
Compulsory surplus *		10,000,000
Compulsory surplus excess (or deficit)		$ 547,195
Adjusted surplus (from above)		$10,547,195
Security surplus*		10,000,000
Security surplus excess (or deficit)		$ 547,195

* Pursuant to ss. 601.41 (4), 623.11, and 623.12, Wis. Stat., and s. Ins 51.80 (7), Wis. Adm. Code, the Commissioner may determine the amount of compulsory surplus and security surplus an insurer is required to have. A stipulation and order was applied to MSI Preferred in 2000, in conjunction with the change in control, and stipulates:
(1) The compulsory surplus shall be the greater of:
(a) 10% of the company's gross premiums written for the preceding four quarters; calculated quarterly, or
(b) $10,000,000
(2) The security surplus shall be the greater of:
(a) The amount computed in accordance with s. Ins 51.80, Wis. Adm. Code, using compulsory surplus as modified by this Stipulation and Order, or
(b) $10,000,000

MSI Preferred Insurance Company
Reconciliation and Analysis of Surplus
For the Three-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000
Surplus, beginning of year	$10,494,826	$10,245,238	$ 3,293,284
Net income	223,024	170,146	167,571
Change in net deferred income tax	75,222	173,751	
Change in non-admitted assets	(245,875)	(91,651)	(22,333)
Cumulative effect of changes in accounting principles		(2,658)	
Capital changes:			
Paid in			500,000
Surplus adjustments:			
Paid in			6,306,716
Surplus, end of year	$10,547,196	$10,494,826	$10,245,238

MSI Preferred Insurance Company
Insurance Regulatory Information System
For the Three-Year Period Ending December 31, 2002

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	2002	2001	2000
#1	Gross Premium to Surplus	248.0%	204.0%	208.0%
#2	Net Premium to Surplus	0.0	0.0	0.0
#3	Change in Net Writings	0.0	0.0	0.0
#4	Surplus Aid to Surplus	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	0.0	0.0	0.0
#6	Investment Yield	4.5*	5.7	8.2
#7	Change in Surplus	0.0	2.0	211.0*
#8	Liabilities to Liquid Assets	63.0	38.0	26.0
#9	Agents' Balances to Surplus	5.0	4.0	3.0
#10	One-Year Reserve Devel. to Surplus	0.0	0.0	0.0
#11	Two-Year Reserve Devel. to Surplus	0.0	0.0	0.0
#12	Estimated Current Reserve Def. To Surplus	0.0	0.0	0.0

Ratio No. 6, Investment Yield, measures the profitability and general quality of the company's investment portfolio over the previous two year period. The score of 4.5% is equal to the expected minimum result of 4.5%. Based on current market returns, this result is not unusual. Ratio No. 7, Change in Surplus, measures the change in surplus from the prior year. The change of 211% from 1999 to 2000 reflects paid in surplus adjustments relating to the stipulation and order noted previously, requiring MSI Preferred to maintain a minimum $10,000,000 compulsory and security surplus. Most of the ratios are 0%, due to the fact that the company cedes 100% of its premiums and losses.

Growth of MSI Preferred Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	$19,682,701	$9,135,506	$10,547,196	$223,024
2001	14,112,877	3,618,054	10,494,824	170,146
2000	11,601,880	1,356,643	10,245,238	167,571
1999	3,293,284	0	3,293,284	212,566

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$26,135,529	$0	$0	0.0%	0.0%	0.0%
2001	21,413,324	0	0	0.0	0.0	0.0
2000	21,343,600	0	0	0.0	0.0	0.0
1999	22,350,895	0	0	0.0	0.0	0.0

The company experienced a 17% increase in gross premium written. All premium and losses are ceded. The increase in surplus from 1999 to 2000 reflects the minimum surplus requirement noted previously, that went into effect in 2000. Subsequent increases in assets were offset by corresponding increases in liabilities, and surplus has remained relatively consistent for the three years under examination.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2002, is accepted.

Examination Reclassifications

	Debit	**Credit**
Premiums, Agents Balances and Installments Booked but Deferred and Not Yet Due	$2,655,681	$
Bills Receivable Taken for Premium		2,655,681
Total reclassifications	$2,655,681	$2,655,681

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Bonds—It is recommended that the company amend its safekeeping agreement to include the provisions requiring:

   That the custodian obligated to indemnify the company for any loss of securities of the company in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction and

   That in the event that there is a loss of the securities for which the custodian is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced

   Action—Compliance

2. Disaster Recovery Plan—It is recommended that the company ensure that the above comments are in a disaster recovery plan as it is updated.

   Action—Compliance

Summary of Current Examination Results

Executive Compensation Filing/Reporting

The company did not follow instructions for completing the Wisconsin Report on Executive Compensation. The instructions state that compensation shall be reported for the chief executive officer and the four most highly paid officers or employees other than the chief executive officer. In addition, all other officers or employees whose compensation exceeds $200,000 shall be reported (as the company reports salaries on a gross basis, they are permitted to use the group surplus as the threshold for reporting). By applying these rules to the officers and salaries noted above, the company failed to include ten individuals whose compensation should have been reported. It is recommended that the company complete the State of Wisconsin Report on Executive Compensation in accordance with the instructions.

Installments Booked but Deferred and Not Yet Due

The company gives policyholders the option of paying premium through automatic electronic withdrawals from a policyholder’s bank account. At year-end, there are installments due in the subsequent year for policies then in force. The company chose to report these subsequent year installments as bills receivable taken for premium. Under SSAP No. 6, these should be reported as installments booked but deferred and not yet due. A reclassification will be made reducing bills receivable taken for premium by $2,655,681 to $0, and increasing installments booked but deferred and not yet due by the same amount to $3,225,500. It is recommended that the company correctly report installments booked but deferred and not yet due.

Reinsurance

Review of reinsurance settlements noted that balances payable at December 31, 2002, were not settled within 35 days subsequent to month end, as specified in the quota share reinsurance agreement between the company and CMIC. It is also stated in the agreement that settlement was to be based on net premium written. Beginning in the fall of 2002, the method of settlement was changed to reflect net premiums collected rather than net premiums written. The agreement was not amended to indicate this change. It is recommended that the company follow the terms of its affiliated reinsurance agreements or amend such agreements to reflect those methods actually in use for the settlement of reinsurance balances.

Advance Premium

When the company receives premium payments for policies that are effective subsequent to year-end, it recognizes advance premium. However, the amount reported as advance premium is the entire in force premium, not the actual collection. This is true even when the amount collected is only an installment. Therefore the company has overstated the advance premium liability. The examiners were unable to reasonably estimate the amount of the overstatement. However, it is recommended that the company report only premium collected in advance of the policy effective date as advance premium.

Affiliated Agreements

The company executed a general agency agreement with MSIPS, and a management and expense agreement with the Cooperative in 2000. In September 2002, the assets and liabilities of the Cooperative were transferred to MSIPS, and the employees of the Cooperative became employees of MSIPS. Services performed by the Cooperative under the management agreement are currently performed by MSIPS. However, the agreement with the Cooperative was never terminated and no management and expense agreement was executed with MSIPS to reflect the change. It is recommended that the company execute agreements for the transactions between affiliates in accordance with s. 617.21, Wis. Stat. and s. Ins 40.04 (2), Wis. Adm. Code, and submit these agreements to the commissioner within 30 days after the adoption of this report.

VIII. CONCLUSION

As of December 31, 2002, the company reported assets of $19,682,701, liabilities of $9,135,506, and policyholders' surplus of $10,547,196.

The company experienced a change of control in 2000, which was approved by the commissioner. Mutual Service Casualty Insurance Company sold 60% of MSI Insurance Company to Country Mutual Insurance Company. At that time, the corporate name of MSI Insurance Company was changed to MSI Preferred Insurance Company and a minimum surplus requirement of $10,000,000 went into effect, stipulated in conjunction with the approval of change of control.

The prior examination noted two recommendations. It was determined that the company was in compliance with both recommendations. There was one reclassification between accounts with no adjustments to surplus as a result of this examination. The current examination also resulted in five recommendations, which are summarized in the "Summary of Comments and Recommendations" section of this report.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Executive Compensation Filing/Reporting—It is recommended that the company complete the State of Wisconsin Report on Executive Compensation in accordance with the instructions.

2. Page 23 - Installments Booked but Deferred and Not yet Due—It is recommended that the company correctly report installments booked but deferred and not yet due.

3. Page 23 - Reinsurance—It is recommended that the company follow the terms of its affiliated reinsurance agreements or amend such agreements to reflect those methods actually in use for the settlement of reinsurance balances.

4. Page 24 - Advance Premium—However, it is recommended that the company report only premium collected in advance of the policy effective date as advance premium.

5. Page 24 - Affiliated Agreements—It is recommended that the company execute agreements for the transactions between affiliates in accordance with s. 617.21, Wis. Stat. and s. Ins 40.04 (2), Wis. Adm. Code, and submit these agreements to the commissioner within 30 days after the adoption of this report.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Russell L. Lamb	Insurance Financial Examiner
Sarah M. Salmon	Insurance Financial Examiner

Respectfully submitted,

Jean M. Suchomel
Examiner-in-Charge